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Supreme Court of the United States

OCTOBER TERM, 1942

In the Matter
of
THE WESTERN PACIFIC RAILROAD COMPANY, *Debtor.*

FREDERICK H. ECKER, *et al., Petitioners,* *v.* WESTERN PACIFIC RAILROAD CORPORATION, *et al., Respondents.*	No. 7
CROCKER FIRST NATIONAL BANK OF SAN FRANCISCO and SAMUEL ARMSTRONG, *Petitioners,* *v.* WESTERN PACIFIC RAILROAD CORPORATION, *et al., Respondents.*	No. 8
THE WESTERN PACIFIC RAILROAD COMPANY, *Cross-Petitioner,* *v.* FREDERICK H. ECKER, *et al., Cross-Respondents.*	No. 20
RECONSTRUCTION FINANCE CORPORATION, *Petitioner,* *v.* WESTERN PACIFIC RAILROAD CORPORATION, *et al., Respondents.*	No. 33
IRVING TRUST COMPANY, *Petitioner,* *v.* CROCKER FIRST NATIONAL BANK OF SAN FRANCISCO, *et al., Respondents.*	No. 61

REPLY BRIEF ON BEHALF OF A. C. JAMES CO., RESPONDENT

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REPLY BRIEF ON BEHALF OF A. C. JAMES CO., RESPONDENT

Scope of this Brief

This proceeding is before this Court under petitions and cross-petitions for certiorari. In order to simplify the presentation and eliminate any duplication of effort that might be felt to be necessary in the complicated situation pre-

sented under the rules, the parties, by a letter stipulation dated August 15, 1942, filed with the Court, agreed upon the time schedule for briefs. This stipulation provided, *inter alia:*

> "* * * that on the main issue, briefs for the parties supporting the Commission Plan should be served and filed on September 15, 1942, and briefs for the parties opposing the Commission Plan served and filed on October 3, 1942, and that **any party** may serve and file reply briefs up to the time of the argument."[1]

This respondent has construed the stipulation as authorizing the filing of this brief by the respondent, supplementing its main brief, and dealing with contentions of the parties supporting the Commission Plan which could not conveniently be discussed within the scope of the affirmative presentation of this respondent's main brief.

One of the parties supporting the Commission Plan has now objected to this construction of the stipulation. This respondent, therefore, in compliance with the request of opposing counsel, furnished counsel for adverse parties with page proofs of this brief, in substantially final form, approximately one week before the argument in this Court, and consents to matter in reply to anything herein contained being included in reply briefs of the opposing parties.

In the main brief filed on behalf of A. C. James Co. on October 3rd in these cases, we sought to present the pertinent facts as to the origin of this respondent's secured claim, and its proposed treatment under the Commission Plan, and as to the property and earning power of the debtor, all of which facts clearly indicate that the secured claim of this respondent should be recognized and refunded in full. This respondent's main brief also necessarily dealt affirmatively with the important questions of the construc-

[1] All emphasis in quoted matter has been supplied throughout this brief unless otherwise noted.

tion of Section 77 of the Bankruptcy Act and its proper application to the facts of this proceeding, which questions are necessarily raised by what we conceive to be the basically erroneous interpretation and application of Section 77 by the Interstate Commerce Commission and the District Court in this proceeding.

In connection with the factual analysis and argument, as presented in our main brief, we have answered the arguments and contentions of the petitioners which appear to be directed to or related to the affirmative presentation on behalf of this respondent. It has, however, appeared necessary and desirable to answer in this brief certain contentions of the petitioners which did not conveniently fall within the scope of the affirmative presentation in this respondent's main brief.

The First Mortgage Trustees have not in their briefs confined themselves to a discussion of the points of law and fact raised by the issues of the extent of the coverage of the debtor's First Mortgage and its General and Refunding Mortgage, respectively, and the value of the property securing the bonds issued under each mortgage (subjects properly within the scope of the duties of such trustees), but have aligned themselves with the Institutional Bondholders Committee and Reconstruction Finance Corporation in supporting the Commission Plan and have adopted and reiterated the contentions of those parties.

The Institutional Bondholders Committee (not organized as a representative committee under subsection (p) of Section 77, but acting under the exceptive clause of that subsection) acts for a group of insurance companies and one bank which hold, in the aggregate, only $16,641,400 principal amount of the First Mortgage bonds, out of a total of $49,290,100. Obviously, therefore, the Institutional Bondholders cannot, under the express provisions of Section 77, represent the remaining $32,648,700 of First Mortgage bonds of the debtor. Under the restrictive provisions of subsection (p) of Section 77, the Institutional Bondholders may act together **"for their own interests and not for others".**

Nor may the First Mortgage Trustees represent the remaining $32,648,700 of First Mortgage bonds of the debtor since subsection (c) (7) of Section 77, which permits the Trustees to file a claim in behalf of all bonds outstanding under their mortgage expressly provides:

> "• • • nothing herein shall constitute such trustee or trustees, the representative or representatives of such holders [bondholders] for the purpose of accepting or rejecting any plan of reorganization."

Congress could not have adopted language by which to prohibit more clearly the active support of the Commission Plan in this proceeding by the First Mortgage Trustees. Those who would represent security holders in a proceeding under Section 77 must comply with the requirements of subsection (p).

It would appear, therefore, unnecessary to make any reply, on behalf of A. C. James Co., to the brief submitted by the First Mortgage Trustees upon the main issues in this controversy. So far as the brief of the First Mortgage Trustees on the lien controversy is concerned, this respondent concurs in and adopts the reply brief filed by the Trustee of the General and Refunding Mortgage. This brief will, therefore, be directed to the briefs heretofore filed on behalf of Institutional Bondholders Committee and Reconstruction Finance Corporation.

POINT I

The petitioners have failed to show any findings or determinations of fact, or adequate substitutes therefor, to support or justify the treatment of this respondent's claim under the Commission Plan.

It is admitted that the Commission found that the securities allocated to this respondent under the Commission Plan would be inadequate to satisfy its claim (R 269), but made no revaluation of the property of the

debtor which would support the refusal to recognize more than half of respondent's secured claim. As is shown in our main brief, neither the prior valuation of the debtor's property, which was reported by the Commission in this proceeding, nor the fully depreciated investment, nor even the capitalization authorized by the Commission Plan, can support this confiscatory treatment of a secured creditor.

The petitioners, Institutional Bondholders Committee and Reconstruction Finance Corporation, have in their briefs conceived elaborate and even ingenious arguments and rationalization (which we believe are demonstrably unsound) in attempting to support the Commission's supposed findings that the equity of debtor's stockholder and the claims of unsecured creditors had no value. **But neither petitioner has even attempted to point out actual findings or determinations of fact which would support the elimination of more than half of this respondent's secured claim.** The treatment of this respondent's secured claim has not been set forth by either petitioner in its "Statement" or mentioned as one of the "Questions Presented".

The Commission has stated that the securities proposed to be given to this respondent will be inadequate in value to satisfy its secured claim in full (R. 269). But the necessity for or fairness of this treatment does not follow from the Commission's prior valuation of the debtor's property, which valuation is clearly in excess of the total of all secured claims (R. 224); it does not follow from the capitalization proposed by the Commission in its Plan which includes 319,441 shares of no par common stock; it does not follow from the preference accorded in the Commission Plan to the Reconstruction Finance Corporation claim, which is also secured by General and Refunding Mortgage bonds, since no sufficient facts or findings appear in justification of such preference; and it does not follow from the supposed findings that the equity of the debtor's stock and claims of unsecured creditors were without value in 1938 and 1939 (R. 269-270).

The conclusion is inescapable from the petitioners' failure to meet this issue that the record and the reports of the Commission are wholly barren of any facts or findings which would justify the elimination of substantially more than half of this respondent's secured claim.

In this connection, the language appearing at page 66 of Reconstruction Finance Corporation's brief demonstrates the petitioners' total inability to justify the treatment of this respondent's claim. The brief says (pp. 65-66):

> "We have demonstrated elsewhere in this brief that the finding of the Commission, approved by the District Court, that the equity and interests of the unsecured creditors and stockholders of the Debtor had no value was unquestionably adequate to support their exclusion from participation in the reorganized company, and that an additional attempted finding of the exact dollar value of the Debtor's assets would have served no useful purpose. **Similar situations may well exist as between senior and junior creditors. Conversely, where it is not controverted that a senior issue is fully satisfied, or that a junior issue has received all that remains after such satisfaction, is it not unnecessary to place a dollar valuation upon the property or securities received by the junior issue?** And where the contributions of different mortgage divisions to the earning power of the total enterprise are clearly shown, may not the new securities, in the application of the determination of this Court in *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510 (1941), that 'the criterion of earning capacity * * * is the essential one,' be distributed essentially on the basis of such contributions without attempting the intermediate formality of a dollar valuation?"

Obviously, the answer to the rhetorical questions posed in the brief must be in the negative where there are, as in this case, three secured creditors holding securities of like character, and one of these creditors is advanced to a position of equality with first mortgage bondholders, while most of this respondent's secured claim is cut off.

POINT II

The Commission Plan and the petitioners' arguments are based upon past earnings of the debtor's property as it existed prior to the substantial changes made from 1927 to 1938, and not upon the present and prospective earning power of the present property which is the property to be reorganized.

In our main brief we have discussed the revenues and earnings of the debtor's property (pp. 21, *et seq.*) and pointed out that the earnings of the property as it existed prior to the substantial changes made from 1927 to 1938 are of little significance in determining present and prospective earning power of the property.

The increases in earning power (in the sense of "capacity to produce earnings") which have necessarily resulted from the construction and operation of the Northern California Extension, the completion in 1938 of the Improvement and Rehabilitation Program, the building of the Dotsero Cut-off on the lines of the Denver & Rio Grande Western, and other relevant factors, have been reflected in the current high level of earnings of the property and in the enhanced prospects for the future. These increases in revenue and earnings are due in large measure to continuing factors other than the war effort. The present enlarged revenues conclusively demonstrate that the transportation facilities now provided by the debtor's plant are "used and useful in the public service". It is no answer to say that the present is a period of industrial expansion instead of industrial depression. The public is clearly entitled to have transportation facilities put at its service adequate to meet its needs in periods of industrial expansion.

The Commission's extended narrative of the past earnings history of the debtor's property (R. 218, *et seq.*, 308, *et seq.*), upon which the Commission Plan was based,

bears little relation to the demonstrated present and future earning capacity of the property. And yet the Commission made only casual reference to the effect of the important changes in the debtor's property which were made from 1927 to 1938, and brushed aside its prior $150,000,000 valuation of the property which had been provided and is adapted and required "for continuing productive use in the service of transportation" (*Securities of Louisville & Nashville R. R.*, 76 I. C. C. 718, 720). If the Commission meant to indicate, what it did not state, that it was reducing its prior valuation as not "justified by the probable earnings reasonably foreseeable for the future" (R. 310), then we contend that it applied a standard which (even though it justified a writing down of the Commission's prior valuations, and this respondent contends it does not) is entirely different from the "earning power" standard of subsection (e) of Section 77.

Furthermore, the Commission's exclusive emphasis on past earnings during the period which included the depression years, and its insistence that not only fixed charges, but contingent charges and dividends, should be covered by "probable earnings reasonably foreseeable" makes it certain, beyond the possibility of successful refutation, that the Commission completely ignored the statutory standard of "earning power of the property, past, present, and prospective, and all other relevant facts."

The Commission also ignored the right of the investor to earn, whenever possible, a reasonable return upon the sound investment devoted to and useful in the public service, and necessary and required to meet all reasonable maximum demands of the public.

In their efforts to support the Commission's capitalization and the resulting Plan, the petitioners have again paraded the past earnings history of the old property, before the substantial changes made from 1927 to 1938 (Institutional Bondholders' brief, pp. 58-60; Reconstruc-

tion Finance Corporation's brief, pp. 9, 37-41), have belittled the demonstrated increase in earning power of the property (Institutional Bondholders' brief, pp. 61-68; Reconstruction Finance Corporation's brief, pp. 41-44, 55), have omitted to mention the actual increased earnings from 1939 to 1942 (Reconstruction Finance Corporation's brief, p. 9) or have sought to minimize or conceal such earnings by reference to theoretical Federal taxes that would have been payable under the unsound capital structure proposed in the Commission Plan if the Plan had been approved and confirmed and in effect during these years (Institutional Bondholders' brief, pp. 6, 7, 62, 63).

In other words, in the eyes of the petitioners, the high level of earnings actually produced by the property during recent years does not demonstrate earning capacity or justify a recognition of the actual investment devoted to the public service. They contend that reduced earnings during years of industrial depression require a write-down of investment. They even contend that theoretical taxes that would be payable after an unjustified and drastic write-down in capitalization should be used to justify the proposed reduction of capitalization by more than forty per cent. This result is manifestly unsound and impracticable, as well as unfair and inequitable to this respondent.

An ingenious attempt to support the Commission's construction of Section 77 appears in the Institutional Bondholders' brief. At pages 56 to 57 of their brief, the Institutional Bondholders apparently admit that the Commission gave no substantial consideration to the investment in the property of the debtor and the Commission's prior valuation as reported in this proceeding (R. 224, 1061-63), since the only evidence of "substantial consideration" suggested in the brief is the fact that the Commission made "many references" to these factors and the Institutional Bondholders' unsupported conclusion

that the earning power of the property is inadequate, taken alone, to support the proposed capitalization.

The brief for the Reconstruction Finance Corporation evades the problem of a discussion of the demonstrated earning capacity of the debtor's railroad system by refraining from any discussion of actual earnings subsequent to the calendar year 1938. It will be remembered that it was in the calendar year 1938 that the Improvement and Rehabilitation Program was completed and the debtor's railroad system, as it exists today, emerged.

The brief for the Institutional Bondholders faces more squarely the facts as to the current level of earnings, but seeks to minimize their significance by a reference (brief, pp. 61-68) to the temporary transportation needs due to war conditions. Not satisfied, however, with the attempt to minimize the current earnings level as allegedly due in large part to war conditions, the brief for the Institutional Bondholders presents tables, charts and graphs where the demonstrated earning power of the debtor's railroad system is substantially reduced by the ingenious device of deducting large sums in taxes, not paid or payable by the debtor, but taxes that the brief insists would have been payable if the drastically reduced scheme of capitalization proposed by the Commission had been in effect (Institutional Bondholders' brief, pp. 7, 58).

There is certainly no adequate attempt made in the brief for the Institutional Bondholders to justify, in relation to the present demonstrated earning capacity of the property, a reduction in asset value from the $150,000,000, which emerged from the Commission's Section 19a valuation proceedings, to the $84,027,559, which amount the Institutional Bondholders' brief (p. 76) calculates would have been the Commission's valuation for reorganization purposes, if it had made such a valuation.

The irrefutable facts as to the present demonstrated earning capacity of the debtor's railroad system can be set out

briefly. The property's earnings available for interest were (as is pointed out in our main brief, pp. 24, 25):

$1,519,916	in	1939
$2,649,797	in	1940
$4,548,138	in	1941
$7,987,512	for the 12 calendar months, August 1, 1941 to July 31, 1942	

Apparently, the Institutional Bondholders' brief intends to build up support for the Commission's theory of capitalization by substantially ignoring the plain standard of valuation of subsection (e) of Section 77, "earning power of the property, past, present, and prospective, and all other relevant facts". Their brief seeks to escape this standard by a process of rephrasing so as to change the content and meaning of the statutory language to the standard of "probable prospective earnings of the property". They fail to face frankly the fact that this latter standard is expressly provided by the statute but in quite a different connection and application. It appears in subsection (b) of Section 77, and is used only in connection with the requirement that fixed charges of the reorganized company shall be adequately covered by the "probable earnings available for the payment thereof". The standard "probable earnings reasonably foreseeable for the future" is frankly invoked by the Commission in explanation of its refusal to recognize investment and value (R. 310), and the same standard apparently provides the basis for the Institutional Bondholders' elaborate attempt to justify the Commission's results.

It is true that the Institutional Bondholders' brief states, at page 38, that the capitalization of the reorganized company was determined "primarily upon the basis of the future earning power of the venture reasonably to be foreseen" and at page 39, that this is the standard of "value for reorganization" adopted by the Commission and approved by the District Court in this proceeding. At other points

in the brief (pp. 40, 64, 81) the Institutional Bondholders state that their "reorganization value" must be supported by "prospective earning power". To add to the general confusion of thought as to the basis upon which the Commission here proceeded, at page 87, the Institutional Bondholders' brief emphatically asserts that this Court in the *du Bois* case insists upon "capitalization of prospective earnings" (a clear departure from this Court's insistence of findings upon **earning capacity**; see 312 U. S. at 525 and 526). Later, the Institutional Bondholders' brief has further rephrased the opinion of this Court in the *du Bois* case and has stated (p. 88) that this Court stresses the "capitalization of earnings" and the "capitalization of prospective earnings" (p. 91). Actually, it is of course significant that this Court, dealing in the *du Bois* case with a statute which did not itself make the clear distinction between "probable prospective earnings" and "earning power", which is found in Section 77, gave, as it did, clear emphasis to **earning capacity**, as distinct from earnings existing at the time, or foreseeable for the immediate future.

Obviously this ingenious rephrasing of the "earning capacity" standard of the *du Bois* decision is in preparation for the figment of "different degrees of probability of prospective earning power" (p. 81 of the brief) which the Institutional Bondholders have created without the slightest evidence of support either in the record or in the reports of the Commission, in an effort to explain the Commission's treatment of capitalization. This fourfold classification of probable future earnings is fully developed at pages 46 and 53 of the Institutional Bondholders' brief. It is adopted in substance in the brief of Reconstruction Finance Corporation (pp. 47, 48, 66).

Three obvious answers can be made to this attempt by the petitioners to build a foundation under the capital structure erected by the Commission in 1937 to 1939:

(a) There is not in Section 77, in either subsection (b) or subsection (e), the slightest authority in support of a

fourfold "probable future earnings" basis for capitalization. The statute expressly and clearly lays down the standard of "probable prospective earnings" for use by the Commission in determining fixed charges, and a standard of "earning power of the property, past, present, and prospective, and all other relevant facts" for use by the Commission in determining values and hence capitalization. Nor can the suggested fourfold classification of probable earnings be read into the opinion of this Court in the *du Bois* case. In fact, that opinion quite properly recognizes the difficulties attendant upon any estimate of future earning power as a whole, difficulties which would prove insurmountable if the petitioners' fantastic scheme should ever be adopted.

(b) There is not the slightest evidence that the Commission in fact used or considered using any such fourfold classification of future probable earnings as that proposed by the petitioners. In fact, the Commission Plan allocates income mortgage bonds, preferred stock and common stock to all classes of creditors and awards to Reconstruction Finance Corporation a preferential distribution of bonds and preferred stock.

(c) The fourfold classification or levels of probable earnings, as conceived by the petitioners, together with their vague doctrine of "equitable equivalents", would, if sanctioned by this Court, represent a complete repudiation of investment and earning power in any proper sense, as the proper yardsticks to be used in determining whether the property rights of investors may be foreclosed for all time, and would permit private rights to be cancelled and annulled in complete disregard of the language of Section 77 and constitutional guarantees.

The Commission's reports in this proceeding (R. 244, 257) make it perfectly clear that the Commission did not give that consideration to the present and prospective earning power of debtor's property and all other relevant facts

which is required by Section 77 of the Bankruptcy Act (see Points I and II, respondent's main brief). The ingenious arguments of the petitioners have not changed or concealed this fact or supplied the findings or determinations and reasons which are lacking in the Commission's reports.

POINT III

Property values must be determined and applied in terms of dollars and not in "degrees of probability of prospective earning power" or in "equitable equivalents".

If there were any doubt that the Commission had failed in its reports in this proceeding to make the necessary findings or determinations of fact which would legally justify and sustain the foreclosure and cancellation of property rights of investors proposed in the Commission Plan, that doubt would be resolved by the extremes to which counsel for the petitioners are driven in their attempts to spell out a justification for the action taken by the Commission and the District Court. In the able brief submitted on behalf of the Institutional Bondholders Committee, counsel, a recognized leader of the reorganization bar, has felt it necessary to devise a new terminology in which to frame the argument that the Commission and the District Court proceeded properly and lawfully. The extremes to which the argument goes is proof of the complete absence of the essential determinations and integrated reasoning as to valuation in the reports of the Commission and the decision of the District Court required to sustain the drastic treatment of investors proposed under the Commission Plan.

A notable instance of the extremes to which counsel for the petitioners have gone is their insistence that, after all, determinations or findings, in terms of dollars, are un-

necessary and meaningless. That the language of those who have negotiated reorganizations has always been, of necessity, one of dollars and cents, just as is the language of business generally, is brushed aside and disregarded by counsel for the petitioners. They brand any requirement of adequate findings and valuation data with such labels as "fictitious mathematical formula", "excessively formalistic, unnecessary and impracticable", "specific dollars and cents findings of value", "precise number of dollars and cents findings", "exact dollars and cents valuation", etc. More specifically, the Institutional Bondholders assert that subsection (e) of Section 77 "does not require the Commission to determine and certify 'value' in detail of exact dollars and cents in every case" (Institutional Bondholders' brief, p. 72) and express no concern over the "failure of the Commission to find a specific number of dollars and cents as the Debtor's prospective earnings" (p. 44).

In support of their argument for the elimination of the dollar sign from reorganization law and practice, the petitioners cite for authority a discursive and diffuse article published in the Yale Law Journal, during the pendency of these cases before this Court, by a member of the New York Bar who has a substantial interest in other reorganization proceedings, the outcome of which may be affected by the decision by this Court of the important questions presented by this proceeding.[1]

In this connection, it should be noted that no respondent in this proceeding has ever asserted that a large railroad property has a "market value" or asked that the "market value" of the property be determined, as is suggested by the petitioners.

Another instance of the ingenuity of counsel for the petitioners in substituting phrasing for reasoning is to be found in their use of language taken from the opinion of

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[1]Bourne, *Findings of "Value" in Railroad Reorganizations*, 51 Yale Law Journal 1057 (1942). See footnotes 1 and 16 of the article.

this Court in the *du Bois* case. As pointed out in the main brief of this respondent (Point VII), there is a complete absence, in the reports of the Commission and in the decision of the District Court, of any adequate findings or determinations of fact which would support the preferential treatment given the Reconstruction Finance Corporation for its claim as a secured creditor. Counsel for the petitioners attempt to meet this by taking the phrase "bundle of rights" from the decision in the *du Bois* case and giving to it an extended content and meaning. As used in the *du Bois* case, the phrase was quite properly used as a convenient and compact expression of the fact that a secured creditor has something more than a bare right to receive from the debtor a given principal sum and, meanwhile, interest at a given rate. The secured creditor has additional rights, such as a definite maturity for principal, a clearcut and well defined lien upon assets, a right to have payments made by way of amortization, a right to have the property of the debtor kept up and properly maintained, and many other rights arising from his contractual relations with the debtor. He has, in the true sense, in his secured claim, a "bundle of rights".

What the petitioners do with this phrase is to extend it far beyond its original content and use it as a catch basket for two entirely different groups of rights. The Reconstruction Finance Corporation holds two entirely distinct claims: one, a claim against the debtor represented by the debtor's notes secured largely by the same sort of collateral that secures the notes held by The Railroad Credit Corporation and this respondent; the other, a claim on Trustees' Certificates, authorized by the Commission and the Court after the properties of the debtor had passed from the control of the debtor to the custody of the Court, and, which, though secured by a first lien on all the assets of the debtor in the custody of the Court, is in the true sense a debt of the Court rather than a debt of the debtor. To talk about this "bundle of rights" as something which must of neces-

sity be dealt with as a whole and as justifying the preference given the Reconstruction Finance Corporation as to its secured claim against the debtor, without any necessary findings or determinations of fact, is a mere evasion of the issue. Certainly there is nothing in the *du Bois* case which supports the argument.

Moreover, the lack of weight in the argument is somewhat emphasized by the fact that the Trustees of the Court hold, as stated in the Institutional Bondholders' brief (p. 110) an amount of cash adequate to permit the Trustees to pay off and discharge at this time the temporary debt incurred by the Trustees for the maintenance of the properties of the debtor.

The resort to adjectives and catch phrases cannot conceal the absence of essential determinations and integrated reasoning as to valuation in the Commission's reports and the District Court's decision. By their oft repeated protest and by express concession (Institutional Bondholders' brief, p. 22), the petitioners admit the complete absence of findings or determinations of value, in the generally accepted sense, by the Commission and the District Court.

Since findings or determinations of value are required by the decisions of this Court and by Section 77 of the Bankruptcy Act, we again urge that affirmance of the Circuit Court of Appeals for the Ninth Circuit, upon this ground alone, is clearly indicated. Where valuation findings are needed, they must necessarily be stated in terms of dollars and not in terms of "degrees of probability" or in "equitable equivalents".

This is not to say that either the Commission or the District Court is required to initiate a lengthy valuation proceeding (in the sense of the current presentation of expert testimony on inventory of physical properties, reproduction cost of items of property, and the like, such as has been common in rate cases arising in the public

utility field) as has been suggested by the petitioners as a necessary result of insistence upon the requirement of determinations of values and supporting data. In the course of a reorganization proceeding under Section 77 of the Bankruptcy Act, a redetermination of values will ordinarily be entirely unnecessary, as we have pointed out in our main brief (p. 101). We say emphatically to this Court, from the background of contact with this proceeding from its start, that no extended presentation of additional valuation data is necessary or desirable in reorganizing the debtor. Only the attempt of the Commission to exclude entire classes of investors, for the purpose of writing down of the capitalization of the debtor to an extent which is unwarranted, in view of its demonstrated earning power, and unauthorized by Section 77, brings the issue of valuation into the picture.

The valuation data available to the Commission from its labors under Section 19a, including complete data as to the true investment, accepted by all parties to the proceeding, constitutes an entirely adequate basis for reorganization. While the clear right of the Commission, under Section 77, to revalue with reference to "earning power", in the event basic changes have occurred permanently impairing the usefulness of the debtor's railroad system or any part thereof in the public service, is recognized by the respondent, any such revaluation (even if it were justified by the facts here presented), would not involve any extended presentation of valuation data as to elements other than "earning power". If Section 77 were properly construed and a reorganization of the debtor effectuated along the lines indicated in the respondent's main brief (Point V), no valuation proceeding would conceivably be required.

POINT IV

Section 77 of the Bankruptcy Act does not make the Commission the "reorganizer" of railroads, subject only to review of its determinations and conclusions as mere administrative matters.

In our main brief, we have attempted to point out the functions of the Commission and the District Court under a proper interpretation of Section 77; at pages 59 to 70 we have shown that the interpretation urged by us is entirely consistent with the Commission's exercise of its authority under Section 20a of the Interstate Commerce Act. Furthermore, at pages 75 to 81 we have answered specifically the position taken by the petitioners that the Commission was constituted "the reorganizer" by Section 77.

In this connection, however, it should be noted that the position taken by Reconstruction Finance Corporation as to the relative functions of the Commission and the District Court (Reconstruction Finance Corporation's brief, pp. 27 and 70 to 88) would reduce the reorganization process to the same status as rate or service regulations and similar administrative functions which have been expressly delegated to the Commission by Congress, and would take away from the district courts their essential judicial powers as courts of bankruptcy in reorganization matters. The district courts would then sit merely to review, as administrative matters, the determinations and conclusions of the Commission. We will, of course, insist that Congress did not, by the enactment of Section 77, delegate to the Commission exclusive authority and power of adjudication of those phases of bankruptcy law which pertain to the reorganization of railroads or constitute the district courts merely reviewing bodies. There is not the slightest indication that Congress intended such drastic changes.

Furthermore, serious doubts would necessarily be raised as to the constitutionality of Section 77 if it could be interpreted as conferring upon the Commission the powers asserted by Reconstruction Finance Corporation.

While the brief of the Institutional Bondholders, at pages 113 to 138, purports to take a position which would confer upon the Commission exclusive jurisdiction in matters affecting the public interest, while preserving to the Courts their "traditional jurisdiction" to determine questions affecting the contractual rights of creditors and stockholders, the Institutional Bondholders have clearly adopted, in substance and effect, practically the same position as that taken by the Reconstruction Finance Corporation.

This is disclosed by the following language from pages 118-119 of the Institutional Bondholders' brief:

> "Indeed the new legislation, as has already been stated, created a procedure under which the Commission has in effect become substituted for the securityholders as the 'reorganizer' and its expert judgment substituted for the 'bargaining process' among securityholders for the determination, in the first instance, not only of the over-all questions of public interest, such as the total amount and character of capitalization to be issued in the reorganization, but also of the financial and other factual problems affecting the distribution of the capitalization in accordance with the legal rights of the old securityholders."

The above language should be considered in connection with the statement at page 114:

> "The findings and conclusions of the Commission upon questions affecting the public interest, *e. g.*, the amount and classification of the new capitalization, are binding and conclusive upon the Court, in the absence of errors of law or lack of supporting evidence. * * *"

and the statement at page 115:

> "The determination of a capital structure for a railroad is essentially a legislative and not a judicial function."

Obviously the determination of the total amount of the capitalization and the character of that capitalization and the distribution of the securities approved in the reorganization are the most important problems arising in the reorganization process. The determination of the amount and character of the capitalization necessarily affects and delimits private property or rights since thereafter the allocation and distribution of the approved securities is largely determined by the doctrine of priorities as laid down by the Court in *Northern Pacific Railway* v. *Boyd*, 228 U. S. 482 and *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106. If Congress has conferred upon the Commission "exclusive and plenary" power to determine the amount and character of capitalization in the public interest, subject only to the extremely limited review announced by the District Court in this case (R. 1596), then for all practical purposes the security holders of a railroad in reorganization have been deprived of the protection of the courts in respect of determinations which are essentially judicial; and the Commission has been constituted a court of bankruptcy in reorganization matters with far greater powers than any district court or court of bankruptcy has ever possessed.

In connection with this matter we call the attention of the Court to Point VI of our main brief.

There is no support either in the language of Section 77 or in the circumstances which led to its enactment that even remotely tends to sustain the extreme position taken by both petitioners.

In Conclusion, this respondent again prays this Court that it dispose of all substantial issues raised before it in this proceeding, and, on the basis of its construction of Section 77, and its disposition of the substantial issues herein raised, that it affirm the decision of the Circuit Court of Appeals for the Ninth Circuit here under review.

Respectfully submitted,

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October 9, 1942.